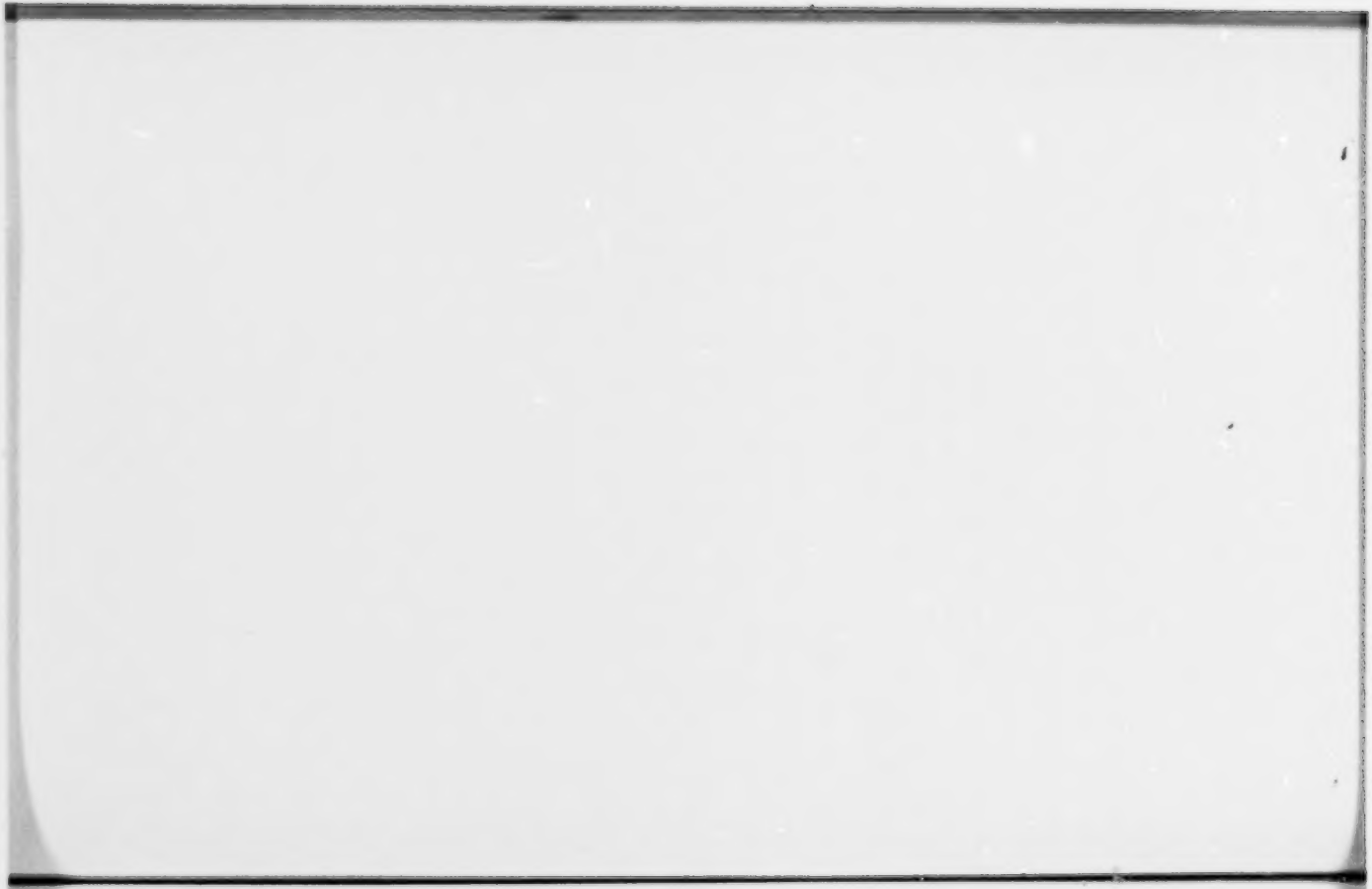

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

No. .

SAX and ROSE ELIZABETH ROHMER,
Petitioners,

—against—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION.

1. The transfer of all serial rights of publication without any limitation of time, for a fixed sum, is not "fixed or determinable annual or periodical gains, profits and income" under Sec. 211(a)(1)(A) of the Internal Revenue Code, and hence is not taxable to the taxpayer Rohmer, a non-resident alien not engaged in business in the United States.

Prior to this decision, which threatens inextricable confusion, the taxability of non-resident aliens not in business here, like Rohmer, under the radically simplified provisions in effect since the 1936 Revenue Act, seemed to present little difficulty, in view of the plain wording of the Statute and Treasury Regulations, and the relevant decisions of the Circuit Courts of Appeals.

Before 1936, non-resident aliens were taxed on all income from United States sources. The 1936 Act lim-

ited the liability of Rohmer's class of alien to their income *subject to withholding at the source,* and carried into the *taxing* section—I. R. C. Sec. 211(a)(1)(A)—the precise wording of the *withholding* section—I. R. C. Sec. 143(b). (See Appendix.) The only change made in both sections from the *withholding* section of prior Acts was the addition of *dividends* to the classifications of income now subject to tax and withholding, making both sections apply to "interest * * * dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, *or other fixed or determinable annual or periodical gains, profits and income.*" (Italics in quotations are ours unless otherwise indicated.)

Ever since the above wording (except for *dividends*) was first adopted in the 1918 Act, the successive Treasury Regulations on withholding have uniformly begun with the words, "Only fixed or determinable annual or periodical income is subject to withholding." Reg. 103 and Reg. 111, Sec. 19.143-2, so begin.

Proceeds of the *sale of property* were never subject to *withholding,* and accordingly a non-resident alien's taxable income since 1936 does not include "profits derived from the sale within the United States of personal property or real property located therein." Reg. 103, Sec. 19.215-1.

The Second Circuit Court of Appeals held on January 3, 1944 in *General Aniline & Film Corp.* v. *Commissioner,* 139 Fed. (2d) 759, that down payments for patent rights, not contingent on future profits, were not taxable to this class of taxpayer, regardless whether title to the patent had passed to the assignee. The Court left open the question whether the future contingent profits would be taxable.

This question was answered in the negative two weeks later by the Court of Appeals for the District of Columbia in *Commissioner* v. *Celanese Corporation,* 140 Fed. (2d) 339, where the Court pointed out that income from the sale of any kind of property (including a patent) is not fixed or determinable annual or periodical income, and hence cannot be taxed to such non-resident aliens, whether it is contingent on future profits or not.

Shortly thereafter, the majority of the Second Circuit Court of Appeals in *Goldsmith* v. *Commissioner,* 143 Fed. (2d) 466, cert. denied 323 U. S. 774, expressed the view that the grant of exclusive motion picture rights in a copyrighted play without limitation of time was a *sale,* but not of capital assets as defined in Revenue Act, 1938, Sec. 117(a)(1).

These decisions seemed to form a logical pattern of interpretation of the new method of taxing non-resident aliens inaugurated in 1936, despite some contrary decisions of the Tax Court and a New York Federal District Court to the effect that any grant of rights less than the whole copyright must generate *royalties,* which in turn must be taxable whether periodical or not. *Irving Berlin,* 42 B. T. A. 668; *Estate of Marton,* 47 B. T. A. 184; *Ehrlich* v. *Higgins,* 52 Fed. Supp. 805. These lower court decisions relied on *Sabatini* v. *Commissioner* (C. C. A. 2d), 98 Fed. (2d) 753, which held that *prior to 1936* a lump sum payment for motion picture rights *for a ten-year period* was a royalty, and hence *taxable*; *withholding* was not involved, and hence the Court did not pass upon or even mention whether this *royalty* was periodical or not. As to a grant of motion picture rights

unlimited in time, the opinion of the majority of the same Court in *Goldsmith* v. *Commissioner, supra,* held that this was in fact a *sale* under Sec. 117 (relating to capital gains), though Judge Chase, who had written the *Sabatini* opinion, still adhered to the view that it was a mere *license* giving rise to *royalty*; no question of periodicity was involved or discussed.

The present decision, in which the Second Circuit in effect overrules its *General Aniline & Film* decision; distinguishes its *Goldsmith* decision by giving the simple concept of "sale" an opposite meaning in two sections of the Internal Revenue Code; sets up a novel criterion of "sale" by non-resident aliens, depending not on transfer of title but on transfer of substantially all rights, what is "substantial" to be determined from case to case; and ends with an extraordinary warning to the bar in footnote 15 that the Court will probably hold taxable contingent payments even after a complete sale. That this last warning implies a direct conflict with the Court of Appeals for the District of Columbia appears even more clearly from the statement in this footnote that "*Commissioner* v. *Hopkinson,* 126 Fed. (2d) 406 (C. C. A. 2), did not involve the portions of the Act imposing a tax on aliens;" this case, which held that contingent proceeds based on future sales after title to a patent passed were taxable as capital gains, not as royalties, was cited in *Commissioner* v. *Celanese Corporation, supra,* as authority for its decision as to the tax on aliens, to which the Second Circuit now warns it did not apply.

The sole ground on which the Court justifies its new position that royalties which it concedes are not *annual or periodical* are still taxable is the "legis-

lative history" of Sec. 211(a)(1)(A), which it says "was not called to our attention before we decided the *General Aniline* case". This "legislative history", the opinion reveals, consists only of the reports of the Congressional Committees on the 1936 Act. (See Appendix for the Senate Report, which is substantially the same as the House Report.) If these reports in fact were susceptible of the Court's construction of them, it is strange that their import was overlooked in all the Treasury Regulations issued since 1936, and also in 1943 in the Government's presentation of the *General Aniline* case, which involved a large amount of tax. The supposed "legislative history" seems to have been a ten years' afterthought on the part of the Government.

The Committee Reports actually seem to lend no support to the construction now placed on them.

When Congress in the 1936 Act adopted for the *taxing* of this class of non-resident aliens the precise language used in the *withholding* section for eighteen years before, *ipsissimis verbis,* with the addition of the single word "dividends", it is too plain for argument that (with that single change) Congress intended in future to tax such persons *only* on income previously subject to *withholding.* And both Senate and House Committee Reports state that this tax *"is collected at the source by withholding as provided for in section 143"*. [S. Rep. No. 2156, 74th Cong., 2d Sess., pp. 21, 23 (1939-1 Cum. Bull. (Part 2) 678, 691-693); H. Rep. No. 2475, 74th Cong., 2d Sess., p. 9 (1939-1 Cum. Bull. (Part 2) 667).]

The Senate Finance Committee's Report briefly describes the taxable income as "income from interest, dividends, rents, wages and salaries and other fixed

and determinable income", while the full wording of the statute is:

> "interest *(except interest on deposits with persons carrying on the banking business),* dividends, rents, salaries, wages, *premiums, annuities, compensations, remunerations, emoluments,* or other fixed *or* determinable *annual or periodical gains, profits, and* income."

It is the casual compression of the statutory words "fixed or determinable annual or periodical gains, profits and income" into "fixed and determinable income" upon which this Court seemingly relies to delete from the statute the words *"annual or periodical"*, which had been the heart of the withholding section for eighteen years, *and still is.*

It would seem no more absurd for a taxpayer to claim that "premiums, annuities, compensations, remunerations, emoluments" [words used in the statute—Secs. 143(b) and 211(a)(1)(A)] were no longer intended to be taxed because omitted in the Committee's cursory summary, than for the Government to contend that the Committee meant thus casually to cut out the core of the section—the *annual or periodical nature* of all the different types of income specified.

To interpret the words *"fixed and determinable"* as having some independent meaning except as a mere abbreviation of the full statutory language reduces them to a tautology of little meaning. Every kind of taxable income which is "fixed" is already "determined".

The words "other fixed *or* determinable gains, profits and income" have been used in the "informa-

tion at source" section of the Revenue Acts (now I. R. C., Sec. 147) since 1918. Their difference in meaning from the more restricted coverage of the withholding section (143) has been well recognized ever since. Treasury Regulations 103 (1940 Act), Sec. 19.147-1, says:

> "Although to make necessary a return of information the income *must be fixed or determinable, it need not be annual or periodical.*"

The Regulations from 1918 to date contain identical language.

But even if the House and Senate Committees had used the words "fixed *or* determinable income", we do not believe anyone would have thought (prior to this case) that they thereby effected the substitution of the "information at source" provisions with their entirely separate elaborate machinery for the "withholding at source" ones, while at the same time incorporating the latter and not the former in the Revenue Act itself!

The Senate Finance Committee's Report does not pretend or need to have statutory precision. Its use of the phrase *"fixed and determinable"*, which is self-contradictory *per se,* is understandable as a short-cut reference to the well known language of the withholding provision; it would seem unthinkable as evidencing an intention to modify in any respect, much less to change the whole letter and spirit of the withholding provisions, *then already of 18 years' standing.*

What the Senate Committee's Report shows beyond peradventure is the intent of Congress to eliminate all tax liability of this class of aliens except income *subject to the existing withholding provisions.* This was because *"in many cases"* (not in all cases) the

tax was hard to collect otherwise. Congress did not attempt further to redefine or reclassify any type of income on account of relative difficulty of collection; obviously the tax on profits on *land* sold in the United States, for example, could readily be collected, but Congress preferred to overlook such refinements, and proceeded on the theory that no attempt would be made in future to collect any tax from such aliens *directly,* but only *through withholding agents,* in accordance with existing law.

One *specific* change was made in 1936 in the previous withholding provisions, and duly noted in the Senate Finance Committee's Report. This was the elimination of the previous exemption of *dividends* from withholding. The specific inclusion naturally negatives any *implied* additional inclusion of non-periodic royalties.

Since the decision below, the Treasury Department has issued I. T. 3781, Bull. Ref. 1946-3-12228 (p. 14), holding that amounts distributed in a reorganization which are taxable as dividends under Sec. 112(c)(2) of the Internal Revenue Code do not constitute dividends or other fixed or determinable annual or periodical income under Sec. 143(b) and are not subject to withholding. The ruling thus re-affirms that not all income of the types specified in the Code is taxable, but only that which is also periodical. *A fortiori* this applies to *royalties,* which are not named in the Code at all, but only in the Regulations—an inclusion only justifiable in the case of *periodical* royalties. This latest ruling seems inconsistent with *De Nobili Cigar Co.* v. *Commissioner* (C. C. A. 2), 143 Fed. (2d) 436, which held Sec. 115(a) distributions subject to withholding, but that aspect is

immaterial here, except to emphasize the inextricable confusion in which the simplified procedure intended by Congress in 1936 is now involved, which can only be clarified by this Court.

The opinion below quotes the Committees' statement of their belief that the revision "will be productive of substantial amounts of additional revenue". This is fully explained, we respectfully submit, by the further explanatory statement in the Senate Report that larger stock transactions would produce more taxes, and that *"the principal increase in revenue will result, however, from withholding tax on dividends heretofore not required"*. Further, it was self-evident that the increase in the flat rate of tax on both individuals and corporations of this class, the disallowance of all deductions, and the total abolition of the personal exemption theretofore enjoyed by all such individuals, would add substantially to the revenue. There is not a word anywhere in the Reports, or in any other legislative record so far as we have found, to suggest that the Committees or Congress expected to get more revenues by subjecting to withholding forms of income not theretofore so subject, *with the single and express exception of dividends.*

Further proof that the Congressional Committees had no intention of singling out non-periodic payments to authors for special taxation may be found in the status of the *Sabatini* case in 1936. In December, 1933, I. T. 2735, C. B. XII-2, 131, had held that "sales" of U. S. serial and motion picture rights were really *"licenses"*, and hence that payments therefor were taxable as royalties. This ruling dealt solely with *Sec. 119* of the Revenue Act—*Income from*

Sources within the United States—and never even mentioned "withholding", nor did its reasoning touch upon witholding in any way. But this ruling was disapproved in *Sabatini,* 32 B. T. A. 705, in 1935, which was not reversed on this point in *Sabatini* v. *Commissioner, supra,* until 1938. If Congress or its Committees gave the question any consideration in 1936, they would have found that under the decision of the highest administrative authority in the Treasury Department such transactions were *sales,* and hence that their proceeds would apparently be tax free under the 1936 Act on any theory.

Departmental practice was, if possible, even more emphatic than the Revenue Acts in upholding the requirement of recurrence.

The opinion below notes that "the Treasury Regulations, under the successive Acts from 1918 to 1934 inclusive, provided that the withholding provisions excluded income derived from the sale of property but included 'royalties'." But there is no intimation in any of these Treasury Regulations that *all* royalties are subject to withholding. The language of Reg. 86 (1934 Act), Reg. 94 (1936 Act) and Reg. 103 (1940 Act) as to withholding are exactly alike as to *royalties.* Art. 143-2 in each begins with the axiom: "*Only fixed or determinable annual or periodical income is subject to withholding.*" Then after listing the statutory provisions it concludes: "But other types of income are included, as, for instance, royalties." Art. 211-7(a) of Reg. 94 and 103 paraphrases the same thought as follows: "* * * *but other fixed or determinable annual or periodical gains, profits and income are also subject to the tax, as, for instance, royalties.*" The fact that Treasury Regulations 94

and 103 use the same verbiage in describing the taxable income of non-resident aliens as they and previous Regulations had used for nearly twenty years as to withholding, seems another conclusive proof that no change was contemplated by Congress in 1936 in the requirement that only periodical income was subject to withholding.

Further proof that not all royalties were subject to withholding is found in the amendment to Reg. 86, Art. 143-2, made March 16, 1935 by Treasury Decision 4535. This added "dividends" to the concluding sentence quoted above making it read: "But other types of income are included, as, for instance, royalties *and dividends.*" The significance of this is that prior to the 1936 Act the majority of dividends were not subject to withholding, but *some* were, and accordingly the Treasury Regulations grouped them in the same category with royalties. It would seem that royalties based on percentages of sales are as obvious an example of periodical income as a once-for-all-time payment for a perpetual license is of non-periodical income. The opinion below relies on the analogy of "interest paid for several years in one sum or rent paid in advance for the use of a building for a period of years." But is not the analogy here rather to the purchase of a perpetual easement for a fixed sum?

The Treasury rulings of lesser authority than the Regulations tell the same confirmatory story of the primary importance of periodicity, only in more detail:

> Bulletin "B" on "Withholding", first published by the Internal Revenue Bureau in 1920, under the 1918 Act, revised July 1, 1927, under the

1926 Act (stressing payments "from time to time");

S. M. 975 (1919) C. B. 1, p. 184 (winnings on horse races not subject to withholding);

L. O. 1024 (1920) C. B. 2, p. 189 (discount, though much like interest, is not subject to withholding; cited with approval this year in *I. T. 3781, supra*);

O. D. 907 (1921) C. B. 4, p. 232 (commission on single transaction not "fixed or determinable annual or periodical income");

Internal Revenue News, May, 1931 (p. 3) (periodical royalties subject to withholding; not so sale for a lump sum);

I. T. 2624, XI-1 C. B. 122 (1932) (book royalties subject to withholding);

G. C. M. 21,575, C. B. 1939-2, p. 172 (art prizes not "fixed or determinable annual or periodical income"; citing *S. M. 975* and *O. D. 907, supra*; cited with approval this year in *I. T. 3781, supra*).

As to the recent decisions of this Court stressing legislative history cited in note 13 of the opinion below, none of them involved taxes, and if there were doubt here as to the legislative intent to tax *only annual or periodical income previously subject to withholding,* the doubt seemingly should be resolved in favor of the taxpayers. *Bowers* v. *New York & Albany Company,* 273 U. S. 346, 350, cited with approval in the unanimous decision of the Supreme Court in *Guaranty Trust Company* v. *U. S.,* 304 U. S. 126, 135.

2. Failure to review this case will encourage litigation in all Circuits, not only as to future payments of this class, but also as to payments made by American citizens to aliens since 1936, without withholding, in reliance on the plain words of the statute.

The emphatic warning to the bar in the opinion below (footnote 15), though it may be only a solemn dictum in conflict with the decision of the Court of Appeals for the District of Columbia in *Commissioner* v. *Celanese Corporation, supra,* seems as a practical matter to be quite as well calculated to create uncertainty as would be a square holding to the same effect.

If such a fundamental concept as a "sale" is to be construed differently in two sections of the Revenue Act, and words of such plain meaning as "annual or periodical" are to be entirely expunged by such a retroactive decision at this late date, we respectfully submit that such an extraordinary result should at least be reached only after a full presentation to this Court. This seems particularly appropriate when the Court below admits that its conclusion is not crystal-clear; and seems by its reliance on the assumed authority of this Court's recent rulings, to place the responsibility for the result upon this Court.

It is clear that the question is of importance to thousands of non-resident authors, and equally so to the American withholding agents, who must decide the question in each case at their peril. Pending a clarifying decision of this Court, the inevitable consequence must be a multiplicity of litigation in every Circuit.

CONCLUSION.

For the reasons stated, it is submitted that the decision of the Circuit Court of Appeals is erroneous; that it involves an important question of Federal law which has not been, but should be, settled by this Court; and that the petition for certiorari should be granted.

Respectfully submitted,

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April 20, 1946.